STATE OF MAINE
PUBLIC UTILITIES COMMISSION

Docket No. 97-580 (II)

August 16, 1999

PUBLIC UTILITIES COMMISSION
Investigation of Central MainePower Company's Revenue Requirements and Rate Design (Phase II)

EXAMINER'S REPORT ON MOTION IN LIMINE

NOTE: This Report contains the recommendation of the Hearing Examiner. Although it is in the form of a draft of a Commission Order, it does not constitute Commission action. Parties may file responses or exceptions to this Report on or before noon, August 20, 1999.

I. BACKGROUND

On March 19, 1999, the Commission issued its decision in Phase II of this docket. In its Order, the Commission noted:

> Due to the complexity of the issues in this matter and the need to commence this proceeding two and one-half years prior to the start of the rate effective year, the parties, as well as the Examiners, have been aware very early on of the need for an update phase as part of this case.

On May 3, 1999, the Hearing Examiner issued a Procedural Order which initiated the Phase II proceeding. That Procedural Order set forth the issues which had been identified in the Phase I Order to be addressed during the Phase II proceeding. The parties were provided with an opportunity to submit corrections or additions which they believed should be made to the initial list of issues. CMP filed its list of issues on May 11, 1999.

On May 13, 1999, a case conference was held on this matter. At that time, the Examiner noted two areas of concern with the list filed by CMP. The first was CMP's

proposal to revise its cost separation study due to its decision to eliminate MainePower. The second area of concern was the Company's proposal to update its attrition study in specific areas where it believed the overall inflation factor was inadequate. The Examiner suggested that it might be possible, and more efficient, to address whether these issues should be in or out of the Phase II case prior to the Company's filing of its direct case. The Examiner asked for comments on this proposal, and both the OPA and the Company submitted comments. CMP in its comments argued that it would be unfair to "cherry pick" the issue to be litigated based on CMP's filing comprehensive list of issues. Any decision to preclude issues should await CMP's filing of its direct case. The OPA noted several areas of concern with CMP's list of issues, however, the OPA did not specifically recommend a procedural vehicle for adjudicating such issues.

After reviewing the comments of the parties, the Examiner concluded that the parties should have the opportunity to fully present their direct cases on all issues they believed to be proper for Phase II. After the direct case filings were made, opposing parties would have the opportunity to object to those issues, they believed went beyond the scope of the Phase II proceeding by the filing motions in limine. The schedule issued to govern Phase II established times for all parties to file such motions.

On July 1, 1999 CMP filed its Phase II direct case. On July 12, 1999, the OPA filed a motion in limine which sought to exclude the Company's testimony and exhibits on the following issues:

1. CMP's modification of its revenue/attrition adjustment to use separate inflation factors for O&M Payroll Expense and Medical Insurance Expense;

2. CMP's elimination of A&G costs allocated to MainePower without adjustment for A&G savings that will be generated by CMP's merger with Energy East; and

3. CMP's proposal to recover the costs of retiring MainePower employees as an "employee transition costs" under 35-A M.R.S.A. Section 3216.

CMP filed its response to the OPA's motion on July 19, 1999.

Prior to addressing the specifics of the OPA's motion we will set out the general principles concerning updates we believe to be applicable to this Phase II proceeding.

II. GENERAL STANDARDS GOVERNING UPDATES

The Company, in its reply to the OPA's motion in limine, argues that the Commission must, if provided with more recent, accurate information, allow the utility to update its case. Quoting *New York Telephone Co. v. PSC,* 29 N.Y. 2nd 164, 324 N.Y.S. 2d 53, 272, N.E. 554 (1971), the Company argues:

> The law is well-settled that the Commission may not rely on a reckoning when actual experience is available and establishes that the predictions have been substantially incorrect. . . To prefer the forecast to the survey is an arbitrary judgment." In a recent case, Boston Gas Co. v. Department of Public Utilities, Mass., 269 N.E.2d 248, pp. 257-259, 1971) the court held that the Commission must consider evidence of attrition, which has actually occurred since the test period. The Massachusetts case rationale is not new. . .

We are in general agreement with the principle that the Commission should where possible rely on the best evidence available in making its decisions. The Commission has, in the past, generally provided the parties with fairly wide latitude to submit updates during the course of rate case proceedings so that the Commission would have the most up to date and reliable data in making its decisions. *Central Maine Power Company, Proposed Increase in Rates (Section 307)*, Docket No. 90-076, Order

Granting and Denying Staff Motion to Strike Testimony (Dec. 26, 1990). As is clear from our past decisions, however, the right to update is not without limits. *Bangor Hydro-Electric Company, Proposed Increase in Rates*, Docket No. 91-010, Procedural Order No. 12 (Sales Forecast Rebuttal Testimony) (Sept. 6, 1991). In Docket No. 90-076, the Commission noted:

> While we rule that "updates" to testimony may be admissible in general, under some circumstances, upon objection, updates may not be admitted. We must consider the admissibility of particular testimony on a case-by-case basis. We must balance between the value of the new, sometimes more accurate testimony, and the extent of the burden on other parties to address it during a significantly shorter time span than is available at the outset of the case. In determining the second factor, the Commission must consider the amount of potential prejudice to a party or to the public generally.

Docket No. 90-076, Order at 4.

In deciding whether to admit updated testimony, we have also held that other factors, such as diligence of the party in developing new evidence, the stage of the proceeding and the time and effort expended on the current evidence should also be considered. *Public Utilities Commission, Investigation Into New England Telephone Company's Cost of Service and Rate Design*, Docket No. 92-130, Procedural Order at 3 (May 5, 1993).

The Company argues that the fact that CMP's update is offered in Phase II is irrelevant. We disagree with CMP's argument that the fact that we are now in Phase II of this proceeding is irrelevant. Due to the complexity of setting rates for restructured electric utilities and the need to do T&D revenue requirements, rate design and stranded costs investigation or "mega-case" for every electric utility in the State, the

Commission initiated our investigation for CMP in September, 1997. Unlike a typical rate case, the Commission has already issued a decision in this proceeding. That decision was based on 88 volumes of testimonial evidence, 370 record exhibits and hundreds of pages of legal briefs. While the Commission did not establish final rates in Phase I, it is clear that the Commission did not intend the Phase I proceeding merely to be a dry run. In commenting on the need to do a Phase II update proceeding, the Commission noted:

> We do not, however, expect the Phase II proceeding to be a replay of this phase. We have attempted, through our decisions here, to narrow the number and scope of the issues for the Phase II proceeding.

In addressing the merits of the OPA's motion then we will look at the likely value of the updated information; the potential prejudice to the other parties and to public interest posed by responding to the updated information in the compressed Phase II time period; the diligence of the updating party in presenting the information; the effort expended on litigating the issue in Phase I; and the extent that the Commission has addressed and decided the issue in Phase I.

III. ISSUES RAISED BY THE OPA'S MOTION

A. Modification of Attrition Adjustment

As part of its updated case, the Company proposed a $6,627,000 increase to test year payroll expense to recognize actual and projected cost increases in this area through the rate year. The Company also proposed an increase of $1,524,324 to test year medical insurance costs to recognize actual and projected increases through

the rate year. A breakdown of the Company's proposals on these two revenue requirement adjustments are presented below:

Projected Salary and Wage Expense

(Thousand of $)	1996 Actual	1997 Actual	1998 Actual	1999 Projected	2000 Projected	2001 Projected	Rate Year Projected
T&D Payroll Expense	$50,528	$52,951	$53,607	$55,215	$56,871	$58,578	$57,156
Percent Change		4.8%	1.2%	3.0%	3.0%	3.0%	

Projected Medical Expense for Active Employees

	1996 Actual	1997 Actual	1998 Actual	1999 Projected	2000 Projected	2001 Projected	Rate Year Projected
T&D Co. Expenditure	$4,169	$4,351	$4,721	$5,146	$5,609	$6,114	$5,694
Percent Change		2.4%	12.2%	9.0%	9.0%	9.0%	

In its motion in limine, the OPA argues that in the Phase I proceeding, the Company, all other parties, and the Commission adopted, as a starting point, the GDPPI-projected inflation factor as the inflation factor to be applied to "all other" expenses not separately annualized. In its Phase II filing the Company is proposing for the first time to apply separate inflation factors to the test-year levels of (a) O&M Payroll Expense and (b) Medical Insurance Expense. The OPA argues that the Company's proposed changes in calculation represent not an "update" but rather a deviation from the methodology used by the Commission in Phase I to calculate the Company's ultimate revenue requirement.

CMP replies that given the fact that CMP had to use a 1996 test year and since over eight months remain before rates go into effect, the Commission must consider actual post-1996 data to arrive at reasonable O&M levels for rates starting in 2000. The Company notes that the Law Court on several occasions has stated that

where the Commission has actual data available to it that makes the test year calculation more accurate, the Commission must consider that data. Citing *Central Maine Power v. Public Utilities Commission,* 153 Me. 228, 136 A.2d 726 (1957) the Company argues that to ignore actual data:

> is to defeat the very idea of fixing rates for the future upon intelligent and informed estimates. . . . The experience of the test year is at best a "guess" for the future. If we can make the "guess" more in line with the probability, in the long run we will have benefited both public and Company.

153 Me. at 235, 136 A.2d at 732.

Due to the Commission's need to commerce this case nearly two and a half years prior to the commencement of the rate year, much of the test year data, including wages and medical expense information, is stale. The question is how can such information best be updated. The Company's update to its wage and medical insurance expense consists of both "known and measurable" type changes from the test year to the present, as well as a change in the methodology for determining how such expenses are projected to increase from present through the rate year. Applying the considerations set forth above, we believe that the Company's proposed updates should be allowed to remain in the case. While the change in the inflation factor being applied to wages and medical insurance expenses does constitute a new "methodology" we do not believe that this particular change is so complex that it cannot be addressed in the context of the Phase II proceeding.

Our decision to allow the Company to update should not be viewed as a decision on the merits of whether, in calculating the attrition adjustment, a separate inflation factor can be applied to certain cost categories. While it may or may not be

possible or appropriate to adopt the Company's proposed ratemaking methodology, we conclude that all interests will best be served by allowing the parties to fully litigate this issue in the context of the Phase II proceeding.

B. Transition Costs for MainePower Employees

As part of its updated case, the Company seeks to increase the amount recovered in T&D revenue requirements for severance payments made pursuant to the requirements of 35-A M.R.S.A. § 3216 related to the Company's decision to terminate MainePower and CMP Technical Services (E-PRO) employees.

The OPA argues in its motion that, employees of MainePower do not constitute "eligible employees" under Section 3216(1)(A) because they are not employees of an electric utility. In addition, the OPA argues that these employees were not terminated as a result of retail access, since retail access, as that term is used in Maine's Restructuring Act, refers to competitive electricity providers offering generation services to retail customers in Maine. The decision to terminate the MainePower business unit was based on competitive forces in other states, chiefly Massachusetts, and MainePower's inability to generate earnings for CMP Group due to low standard offer prices in those states.

CMP counters that the OPA's argument on this issue goes to the merits of CMP's request rather than to whether the issue is a proper one for update. Therefore, the OPA's motion is more in the way of a motion for summary judgment than a motion in limine. According to CMP, since the facts at this point support CMP's contention that its MainePower employees are "eligible employees" as defined by 35-A M.R.S.A. § 3216, if summary judgment is granted at this time judgment should be entered in favor of CMP.

The request to include additional severance benefits relates to an event which occurred subsequent to the time of its Phase I filing. The Company has not changed its methodology as to how benefits are calculated. While there may be an issue as to whether these employees terminated were eligible for benefits under 35-A M.R.S.A. § 3216, that issue should be addressed by the Commission during the course of this proceeding. The Company's update on this issue was proper and, therefore, the OPA's motion on this issue is denied.

C. Cost Separations Update for Elimination of MainePower

In its Phase II filing, the Company updated A&G cost separations to reflect the Commission's decision in Phase I; the Company's elimination of MainePower; the removal of North Augusta Office Annex costs; and the inclusion of a portion of the energy trading and marketing costs in T&D revenue requirements.

In its motion in limine, the OPA requests that the Commission eliminate from the Phase II proceeding, CMP's revision to its cost separations study to reflect the elimination of the MainePower business operation. The OPA argues that the Company's revision to its cost study to reflect subsequent events is asymmetric since there have been two significant developments at the corporate level since the conclusion of Phase I; the closure of MainePower and CMP's merger with Energy East. While the Company has presented its case to reflect what it believes will be the increased cost associated with the elimination of MainePower, the revised cost study totally ignores the likely decrease of CMP's A&G's costs as a result of the merger.

The Company responds that there is no linkage between costs associated with the elimination of MainePower and potential merger savings. The merger

agreement with Energy East provides for up to 18 months for completion of all regulatory approvals. At this point, then it is not possible to know when, or even whether, the merger will close. Therefore, it is simply not possible to impute any savings associated with the merger as part of this case.

In Phase I of the case, CMP's cost separation study was submitted by Company Comptroller Michael Caron, and Rate Analyst Dufour (hereinafter, "Caron/Dufour"). Using test year accounting data, Caron/Dufour separated costs into five separate business groups: the holding company, the T&D utility, the wholesale and retail marketing business (MainePower), the operations support division, and the other subsidiaries. The first step in the Caron/Dufour separations process was to remove directly identifiable and assignable generation costs, stranded costs and rate proceeding "eliminations." After removing these costs, the remaining financial data were segregated into the four remaining cost categories: T&D, Wholesale and Retail, Operating Support Division and the Holding Company.

After this separation, OSD and Holding Company costs were approportioned between T&D and the wholesale and retail business units. This was accomplished when possible on a direct basis and for much of the rest of an indirect cost allocation basis. A pool of residual costs remained after these direct and indirect allocations were completed, and these were assigned to the T&D and wholesale units based on a global allocator. The Company's global allocator was based on the revenues, expenses and assets of each of the operating units. Each of these factors were derived by dividing the amount for the operating unit by the total amount for the factor. The global allocator was developed by giving each factor an equal weight

and summing the products. Based on these assignments, Holding Company and OSD costs were allocated between T&D and Wholesale/Retail as follows:

	Holding Company Costs ($000)	OSD Costs ($000)
Transmission & Distribution	$1,451	$52,062
Wholesale/Retail	177	3,999
Total	$1,628	$56,061

The Company's presentation was questioned by the OPA witness Jim Dittmer, the IECG's witness Dr. Silkman and in the Advisory Staff's Bench Analysis. The Bench Analysis noted that while divestiture of the generation function will eliminate approximately one-third of the Company's operations, measured by investment, CMP assigned only 4.4 percent of total overheads and 5.3 percent of A&G expenses to the generation function as a result of the asset sale. Out of a total of 458 administrative employees, the Company has only projected a reduction of 18 positions as a result of divestiture. In addition, the Bench Analysis expressed concern that CMP failed to recognize any costs as allocable to new lines of business that the Company intends to enter, or to subsidiaries that the Company intends to grow. Finally, the Bench Analysis expressed concern with the Company's top-down approach, which looked at the costs that would be eliminated when it left the generation business, rather than what it would cost to run its T&D business.

Based on these concerns, the Bench Analysis presented two alternative methods for allocating CMP's administrative or overhead costs between its T&D and other operations. Both methodologies involved the allocation of overheads to generation, in addition to T&D and W&R, as a means of projecting the amount of costs

which no longer were necessary or which were attributable to CMP's emerging lines of business.

The Commission ultimately rejected all of the methodologies presented. The Commission found the Company's method to be flawed for not properly recognizing the A&G costs associated with the Company's new lines of business. The Commission, however, also found the Bench Analysis's approach to be flawed in that it did not properly recognize the lost economies of scope which would likely occur when the generation function was divested from the integrated electric utility. In coming to its decision on this issue in this case, the Commission noted:

> The cost separations issue contains some of the most difficult questions in this case because of the evolutionary nature of the electric industry and of CMP itself. We do not know for certain what the organizational structure of CMP will be or what lines of business outside of T&D the Company will actually pursue. We agree with the Company's assertion that at least during the initial phases of restructuring, many of the Company's current A&G costs will be unavoidable. It is also possible that certain areas will see increasing costs as CMP adjusts to its role as an "intermediary" between customers and suppliers. Finally, the level of CMP's non-core activities remains uncertain, and thus, the portion of costs that should be allocated away from the T&D operations requires informed judgment on our part.

Phase I Order at 14.

The Commission, using its judgment, concluded that the test year adjusted A&G costs should be reduced by $1.9 million, or 4% less than the Company's recommendation. In coming to its decision of the appropriate level of A&G costs to be allocated to the T&D company, the Commission was aware of the fact that the Company had already downsized MainePower. At the hearing, Mr. Caron testified that during the rate year the Company's senior management would likely be spending a

disproportionate share of time on the startup businesses compared to the revenues, and hence, costs allocated to such business units. This underallocation, however, was more than compensated for by the fact that the Company in its study had allocated MainePower costs based on an assumption of maximum native market share and that the Company had already significantly downsized MainePower.

The Commission in Phase I of this case then set, what it believed to be a reasonable level of A&G costs for a T&D only company in the first year of the restructured utility industry. We do not believe that it is possible to merely "update" this finding by removing the amount allocated for MainePower.

In our Phase I Order, we recognized that we would be in a much better position to address the cost separations issue in our next CMP rate case when we actually have a record of T&D activities and expenses upon which to base our decision. While facts have changed since the time of the close of the record in Phase I, the new developments do not shed any further light on what the appropriate level of A&G costs for the T&D only utility should be during the rate year. We are not persuaded by CMP's Phase II filing, that our finding of what constitutes a reasonable level of A&G costs is erroneous.

Given the complexity of the issue, the burden of responding to an "updated" cost separations study in the context of the abbreviated Phase II proceeding would be substantial. We do not believe the value of the updated information outweighs the potential prejudice to the parties and the public interest. Therefore, we will grant the OPA's motion to exclude the Company's update to the A&G allocations in the Company's cost separations study resulting from the elimination of the Company's

MainePower subsidiary. Given our decision not to revisit the cost separations issue, as a matter of symmetry and fairness, we will not require the Company to reduce A&G costs associated with the closing of the North Augusta annex.

Dated: August 16, 1999

Submitted by:

Charles Cohen
Hearing Examiner